

Introduced by Senator DuttonFebruary 24, 2012

An act to amend Sections 18152 and 18152.5 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

SB 1396, as introduced, Dutton. Income taxes: gross income.

The Personal Income Tax Law in modified conformity with federal income tax laws provides that gross income does not include 50% of any gain from the sale or exchange of qualified small business stock, as defined, held for more than 5 years, as provided.

Vote: majority. Appropriation: no. Fiscal committee: no.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 18152 of the Revenue and Taxation Code
2 is amended to read:
3 18152. (a) Section 1202 of the Internal Revenue Code, relating
4 to 50-percent exclusion for gain from certain small business stock,
5 shall not apply.
6 (b) ~~Any~~ *For purposes of this part, any* reference in the Internal
7 Revenue Code to the “exclusion allowed under Section 1202”
8 ~~shall, for purposes of this part, shall~~ be modified to refer to the
9 exclusion allowed under Section 18152.5.
10 SEC. 2. Section 18152.5 of the Revenue and Taxation Code
11 is amended to read:

1 18152.5. (a) For purposes of this part, gross income shall not
2 include 50 percent of any gain from the sale or exchange of
3 qualified small business stock held for more than five years.

4 (b) (1) If the taxpayer has eligible gain for the taxable year
5 from one or more dispositions of stock issued by any corporation,
6 the aggregate amount of the gain from dispositions of stock issued
7 by the corporation which may be taken into account under
8 subdivision (a) for the taxable year shall not exceed the greater of
9 either of the following:

10 (A) Ten million dollars (\$10,000,000) reduced by the aggregate
11 amount of eligible gain taken into account by the taxpayer under
12 subdivision (a) for prior taxable years and attributable to
13 dispositions of stock issued by the corporation.

14 (B) Ten times the aggregate adjusted bases of qualified small
15 business stock issued by the corporation and disposed of by the
16 taxpayer during the taxable year. For purposes of subparagraph
17 (B), the adjusted basis of any stock shall be determined without
18 regard to any addition to basis after the date on which the stock
19 was originally issued.

20 (2) For purposes of this subdivision, the term “eligible gain”
21 means any gain from the sale or exchange of qualified small
22 business stock held for more than five years.

23 (3) (A) In the case of a married individual filing a separate
24 return, subparagraph (A) of paragraph (1) shall be applied by
25 substituting five million dollars (\$5,000,000) for ten million dollars
26 (\$10,000,000).

27 (B) In the case of a married taxpayer filing a joint return, the
28 amount of gain taken into account under subdivision (a) shall be
29 allocated equally between the spouses for purposes of applying
30 this subdivision to subsequent taxable years.

31 (C) For purposes of this subdivision, marital status shall be
32 determined under Section 7703 of the Internal Revenue Code.

33 (c) For purposes of this section:

34 (1) Except as otherwise provided in this section, the term
35 “qualified small business stock” means any stock in a C corporation
36 which is originally issued after August 10, 1993, if both of the
37 following apply:

38 (A) As of the date of issuance, the corporation is a qualified
39 small business.

(B) Except as provided in subdivisions (f) and (h), the stock is acquired by the taxpayer at its original ~~issue (directly issue, directly~~ or through an ~~underwriter) underwriter~~, in either of the following manners:

(i) In exchange for money or other ~~property (not property, not including stock) stock~~.

(ii) As compensation for services provided to the ~~corporation (other corporation, other than services performed as an underwriter of the stock) stock~~.

(2) (A) Stock in a corporation shall not be treated as qualified small business stock unless, during substantially all of the taxpayer's holding period for the stock, the corporation meets the active business requirements of subdivision (e) and the corporation is a C corporation.

(B) (i) Notwithstanding subdivision (e), a corporation shall be treated as meeting the active business requirements of subdivision (e) for any period during which the corporation qualifies as a specialized small business investment company.

(ii) For purposes of clause (i), the term "specialized small business investment company" means any eligible ~~corporation (as corporation, as defined in paragraph (4) of subdivision (e)) (e)~~, that is licensed to operate under Section 301(d) of the Small Business Investment Act of ~~1958 (as 1958, as in effect on May 13, 1993) 1993~~.

(3) (A) Stock acquired by the taxpayer shall not be treated as qualified small business stock if, at any time during the four-year period beginning on the date two years before the issuance of the stock, the corporation issuing the stock ~~purchased (directly purchased, directly or indirectly) indirectly~~, any of its stock from the taxpayer or from a related ~~person (within person, within the meaning of Section 267(b) or 707(b)) 707(b)~~, to the taxpayer.

(B) Stock issued by a corporation shall not be treated as qualified small business stock if, during the two-year period beginning on the date one year before the issuance of the stock, the corporation made one or more purchases of its stock with an aggregate ~~value (as value, as of the time of the respective purchases) purchases~~, exceeding 5 percent of the aggregate value of all of its stock as of the beginning of the two-year period.

(C) If any transaction is treated under Section 304(a) of the Internal Revenue Code as a distribution in redemption of the stock

1 of any corporation, for purposes of subparagraphs (A) and (B), the
2 corporation shall be treated as purchasing an amount of its stock
3 equal to the amount treated as a distribution in redemption of the
4 stock of the corporation under Section 304(a) of the Internal
5 Revenue Code.

6 (d) For purposes of this section:

7 (1) The term “qualified small business” means any domestic
8 ~~corporation (as corporation, as defined in Section 7701(a)(4) of~~
9 ~~the Internal Revenue Code) Code~~, which is a C corporation if all
10 of the following apply:

11 (A) The aggregate gross assets of the ~~corporation (or~~
12 ~~corporation, or any predecessor thereof) thereof~~, at all times on
13 or after July 1, 1993, and before the issuance did not exceed fifty
14 million dollars (\$50,000,000).

15 (B) The aggregate gross assets of the corporation immediately
16 after the ~~issuance (determined issuance, determined by taking into~~
17 ~~account amounts received in the issuance) issuance~~, do not exceed
18 fifty million dollars (\$50,000,000).

19 (C) At least 80 percent of the corporation’s payroll, as measured
20 by total dollar value, is attributable to employment located within
21 California.

22 (D) The corporation agrees to submit those reports to the
23 Franchise Tax Board and to shareholders as the Franchise Tax
24 Board may require to carry out the purposes of this section.

25 (2) (A) For purposes of paragraph (1), the term “aggregate
26 gross assets” means the amount of cash and the aggregate adjusted
27 basis of other property held by the corporation.

28 (B) For purposes of subparagraph (A), the adjusted basis of any
29 property contributed to the corporation (or other property with a
30 basis determined in whole or in part by reference to the adjusted
31 basis of property so contributed) shall be determined as if the basis
32 of the property contributed to the corporation immediately after
33 the contribution was equal to its fair market value as of the time
34 of the contribution.

35 (3) (A) All corporations which are members of the same
36 parent-subsidiary controlled group shall be treated as one
37 corporation for purposes of this subdivision.

38 (B) For purposes of subparagraph (A), the term
39 “parent-subsidiary controlled group” means any controlled group

1 of corporations as defined in Section 1563(a)(1) of the Internal
2 Revenue Code, except that both of the following shall apply:

3 (i) “More than 50 percent” shall be substituted for “at least 80
4 percent” each place it appears in Section 1563(a)(1) of the Internal
5 Revenue Code.

6 (ii) Section 1563(a)(4) of the Internal Revenue Code shall not
7 apply.

8 (e) (1) For purposes of paragraph (2) of subdivision (c), the
9 requirements of this subdivision are met by a corporation for any
10 period if during that period both of the following apply:

11 (A) At least 80 percent (by value) of the assets of the corporation
12 are used by the corporation in the active conduct of one or more
13 qualified trades or businesses in California.

14 (B) The corporation is an eligible corporation.

15 (2) For purposes of paragraph (1), if, in connection with any
16 future qualified trade or business, a corporation is engaged in:

17 (A) Startup activities described in Section 195(c)(1)(A) of the
18 Internal Revenue Code,

19 (B) Activities resulting in the payment or incurring of
20 expenditures which may be treated as research and experimental
21 expenditures under Section 174 of the Internal Revenue Code, or

22 (C) Activities with respect to in-house research expenses
23 described in Section 41(b)(4) of the Internal Revenue Code, then
24 assets used in those activities shall be treated as used in the active
25 conduct of a qualified trade or business. Any determination under
26 this paragraph shall be made without regard to whether a
27 corporation has any gross income from those activities at the time
28 of the determination.

29 (3) For purposes of this subdivision, the term “qualified trade
30 or business” means any trade or business other than any of the
31 following:

32 (A) Any trade or business involving the performance of services
33 in the fields of health, law, engineering, architecture, accounting,
34 actuarial science, performing arts, consulting, athletics, financial
35 services, brokerage services, or any trade or business where the
36 principal asset of the trade or business is the reputation or skill of
37 one or more of its employees.

38 (B) Any banking, insurance, financing, leasing, investing, or
39 similar business.

1 (C) Any farming ~~business (including~~ *business, including* the
2 business of raising or harvesting ~~trees~~) *trees*.

3 (D) Any business involving the production or extraction of
4 products of a character with respect to which a deduction is
5 allowable under Section 613 or 613A of the Internal Revenue
6 Code.

7 (E) Any business of operating a hotel, motel, restaurant, or
8 similar business.

9 (4) For purposes of this subdivision, the term “eligible
10 corporation” means any domestic corporation, except that the term
11 shall not include any of the following:

12 (A) A DISC or former DISC.

13 (B) A corporation with respect to which an election under
14 Section 936 of the Internal Revenue Code is in effect or which has
15 a direct or indirect subsidiary with respect to which the election
16 is in effect.

17 (C) A regulated investment company, real estate investment
18 trust (REIT), or real estate mortgage investment conduit (REMIC).

19 (D) A cooperative.

20 (5) (A) For purposes of this subdivision, stock and debt in any
21 subsidiary corporation shall be disregarded and the parent
22 corporation shall be deemed to own its ratable share of the
23 subsidiary’s assets, and to conduct its ratable share of the
24 subsidiary’s activities.

25 (B) A corporation shall be treated as failing to meet the
26 requirements of paragraph (1) for any period during which more
27 than 10 percent of the value of its ~~assets (in assets, in excess of~~
28 ~~liabilities)~~ *liabilities*, consists of stock or securities in other
29 corporations which are not subsidiaries of the ~~corporation (other~~
30 ~~corporation, other~~ than assets described in paragraph ~~(6))~~ (6).

31 (C) For purposes of this paragraph, a corporation shall be
32 considered a subsidiary if the parent owns more than 50 percent
33 of the combined voting power of all classes of stock entitled to
34 vote, or more than 50 percent in value of all outstanding stock, of
35 the corporation.

36 (6) For purposes of subparagraph (A) of paragraph (1), the
37 following assets shall be treated as used in the active conduct of
38 a qualified trade or business:

1 (A) Assets that are held as a part of the reasonably required
2 working capital needs of a qualified trade or business of the
3 corporation.

4 (B) Assets that are held for investment and are reasonably
5 expected to be used within two years to finance research and
6 experimentation in a qualified trade or business or increases in
7 working capital needs of a qualified trade or business. For periods
8 after the corporation has been in existence for at least two years,
9 in no event may more than 50 percent of the assets of the
10 corporation qualify as used in the active conduct of a qualified
11 trade or business by reason of this paragraph.

12 (7) A corporation shall not be treated as meeting the
13 requirements of paragraph (1) for any period during which more
14 than 10 percent of the total value of its assets consists of real
15 property that is not used in the active conduct of a qualified trade
16 or business. For purposes of the preceding sentence, the ownership
17 of, dealing in, or renting of, real property shall not be treated as
18 the active conduct of a qualified trade or business.

19 (8) For purposes of paragraph (1), rights to computer software
20 that produces active business computer software ~~royalties (within~~
21 ~~royalties, within~~ the meaning of Section 543(d)(1) of the Internal
22 Revenue ~~Code) Code~~, shall be treated as an asset used in the active
23 conduct of a trade or business.

24 (9) A corporation shall not be treated as meeting the
25 requirements of paragraph (1) for any period during which more
26 than 20 percent of the corporation's total payroll expense is
27 attributable to employment located outside of California.

28 (f) If any stock in a corporation is acquired solely through the
29 conversion of other stock in the corporation that is qualified small
30 business stock in the hands of the taxpayer, both of the following
31 shall apply:

32 (1) The stock so acquired shall be treated as qualified small
33 business stock in the hands of the taxpayer.

34 (2) The stock so acquired shall be treated as having been held
35 during the period during which the converted stock was held.

36 (g) (1) If any amount included in gross income by reason of
37 holding an interest in a pass-through entity meets the requirements
38 of paragraph (2), then both of the following shall apply:

39 (A) The amount shall be treated as gain described in subdivision
40 (a).

(B) For purposes of applying subdivision (b), the amount shall be treated as gain from a disposition of stock in the corporation issuing the stock disposed of by the pass-through entity and the taxpayer's proportionate share of the adjusted basis of the pass-through entity in the stock shall be taken into account.

(2) An amount meets the requirements of this paragraph if both of the following apply:

(A) The amount is attributable to gain on the sale or exchange by the ~~pass-through~~ *passthrough* entity of stock that is qualified small business stock in the hands of the ~~entity (determined entity, determined by treating the entity as an individual)~~ *individual*, and that was held by that entity for more than five years.

(B) The amount is includable in the gross income of the taxpayer by reason of the holding of an interest in the entity that was held by the taxpayer on the date on which the ~~pass-through~~ *passthrough* entity acquired the stock and at all times thereafter before the disposition of the stock by the ~~pass-through~~ *passthrough* entity.

(3) Paragraph (1) shall not apply to any amount to the extent the amount exceeds the amount to which paragraph (1) would have applied if the amount was determined by reference to the interest the taxpayer held in the pass-through entity on the date the qualified small business stock was acquired.

(4) For purposes of this subdivision, the term "~~pass-through~~ *passthrough* entity" means any of the following:

(A) Any partnership.

(B) Any ~~S~~ "S" corporation.

(C) Any regulated investment company.

(D) Any common trust fund.

(h) For purposes of this section:

(1) In the case of a transfer described in paragraph (2), the transferee shall be treated as meeting both of the following:

(A) Having acquired the stock in the same manner as the transferor.

(B) Having held the stock during any continuous period immediately preceding the transfer during which it was ~~held (or held, or treated as held under this subdivision)~~ *subdivision*, by the transferor.

(2) A transfer is described in this subdivision if the transfer is any of the following:

(A) By gift.

1 (B) At death.

2 (C) From a partnership to a partner of stock with respect to
3 which requirements similar to the requirements of subdivision (g)
4 are met at the time of the transfer ~~(without transfer, without regard~~
5 ~~to the five-year holding period requirement) requirement.~~

6 (3) Rules similar to the rules of Section 1244(d)(2) of the
7 Internal Revenue Code shall apply for purposes of this section.

8 (4) (A) In the case of a transaction described in Section 351 of
9 the Internal Revenue Code or a reorganization described in Section
10 368 of the Internal Revenue Code, if qualified small business stock
11 is exchanged for other stock that would not qualify as qualified
12 small business stock but for this subparagraph, the other stock
13 shall be treated as qualified small business stock acquired on the
14 date on which the exchanged stock was acquired.

15 (B) This section shall apply to gain from the sale or exchange
16 of stock treated as qualified small business stock by reason of
17 subparagraph (A) only to the extent of the gain that would have
18 been recognized at the time of the transfer described in
19 subparagraph (A) if Section 351 or 368 of the Internal Revenue
20 Code had not applied at that time. The preceding sentence shall
21 not apply if the stock that is treated as qualified small business
22 stock by reason of subparagraph (A) is issued by a corporation
23 ~~that~~ ~~(as that, as~~ of the time of the transfer described in
24 ~~subparagraph (A))~~ (A), is a qualified small business.

25 (C) For purposes of this paragraph, stock treated as qualified
26 small business stock under subparagraph (A) shall be so treated
27 for subsequent transactions or reorganizations, except that the
28 limitation of subparagraph (B) shall be applied as of the time of
29 the first transfer to which the limitation ~~applied~~ ~~(determined~~
30 ~~applied, determined~~ after the application of the second sentence
31 of subparagraph ~~(B))~~ (B).

32 (D) In the case of a transaction described in Section 351 of the
33 Internal Revenue Code, this paragraph shall apply only if
34 immediately after the transaction the corporation issuing the stock
35 owns directly or indirectly stock representing ~~control~~ ~~(within~~
36 ~~control, within~~ the meaning of Section 368(c) of the Internal
37 Revenue ~~Code)~~ Code, of the corporation whose stock was
38 exchanged.

39 (i) For purposes of this section:

(1) In the case where the taxpayer transfers ~~property (other than money or stock)~~ *stock*, to a corporation in exchange for stock in the corporation, both of the following shall apply:

(A) The stock shall be treated as having been acquired by the taxpayer on the date of the exchange.

(B) The basis of the stock in the hands of the taxpayer shall in no event be less than the fair market value of the property exchanged.

(2) If the adjusted basis of any qualified small business stock is adjusted by reason of any contribution to capital after the date on which the stock was originally issued, in determining the amount of the adjustment by reason of the contribution, the basis of the contributed property shall in no event be treated as less than its fair market value on the date of the contribution.

(j) (1) If the taxpayer has an offsetting short position with respect to any qualified small business stock, subdivision (a) shall not apply to any gain from the sale or exchange of the stock unless both of the following apply:

(A) The stock was held by the taxpayer for more than five years as of the first day on which there was such a short position.

(B) The taxpayer elects to recognize gain as if the stock was sold on that first day for its fair market value.

(2) For purposes of paragraph (1), the taxpayer shall be treated as having an offsetting short position with respect to any qualified small business stock if any of the following apply:

(A) The taxpayer has made a short sale of substantially identical property.

(B) The taxpayer has acquired an option to sell substantially identical property at a fixed price.

(C) To the extent provided in regulations, the taxpayer has entered into any other transaction that substantially reduces the risk of loss from holding the qualified small business stock. For purposes of the preceding sentence, any reference to the taxpayer shall be treated as including a reference to any person who is ~~related (within related, within the meaning of Section 267(b) or 707(b) of the Internal Revenue Code)~~ *Code*, to the taxpayer.

(k) The Franchise Tax Board may prescribe those regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of

1 this section through splitups, shell corporations, partnerships, or
2 otherwise.

3 (l) It is the intent of the Legislature that, in construing this
4 section, any regulations that may be promulgated by the Secretary
5 of the Treasury under Section 1202(k) of the Internal Revenue
6 Code shall apply to the extent that those regulations do not conflict
7 with this section or with any regulations that may be promulgated
8 by the Franchise Tax Board.

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